RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

Mar. 9, 1988 **LETTER 986**

Feb. 26 DJIA 2023.21; PTI 2657; A-D Ratio -8.77
Mar 4 DJIA 2057.86; PTI 2669; A-D Ratio -8.23
Current Dow Yield: 3.38%; Dow P/E: 14.9
Dow 200-day mov aver: 2225; DowPow: 1134

THE MARKET: On February 29 the D-J Industrial Average finally hurdled its January 7 peak of 2051.89, closing at a new post-crash high of 2071.62. The question: "Did this constitute a Dow Theory bull signal?" My answer is that if this were a primary bull market I would have reacted to the Dow confirmation very bullishly. But since we are in a primary bear market, I must continue to advise caution. As it is, I regard the February 29 Dow breakout as a signal that the secondary trend of the market is up.

My Primary Trend Index (PTI) is now pushing up and away from its 89-week moving average, and this is a definite plus for the market. My opinion is that the Dow and the major averages are trying to correct halfway back to their 1987 highs (thus recovering 50% of their bear market losses). As I've stated repeatedly, such action (i.e., a 50% recovery) would take the Dow back to roughly the 2230 area.

However (there's always a "however") the market is becoming increasingly overbought and vulnerable in that the advance-decline ratio is now up twelve of the last thirteen weeks. Thus each new up-week pushes the market nearer to what I term "super-strain." There's no question about it -- this market is overbought.

Along the same lines of vulnerability, it bothers me that the D-J Utility Average acts so poorly -- this despite the fact that the utility stocks have been widely recommended. The Utility weakness is all the more dramatic because the interest-sensitive Utility Average has been weak (1) in the face of declining interest rates (2) in the face of a persistently strong bond market, and (3) in the face of very weak oil prices. All three of these would ordinarily be major pluses for the Utilities.

If you remember, it was the bellwether Utility Average which provided the first hints of trouble in 1987 (the Utilities topped out in January, followed by the A-D ratio topping out in March). I find myself wondering whether they are not doing the same thing again.

What could the problem with utilities be? Very simply, the utilities could be reflecting a declining rate of electricity and gas consumption somewhere ahead. The Utility Average tends to be the most conservative Average -- it is the investment-grade average. Thus, it often provides hints as to what the most cautious and conservative money is doing.

BIG PICTURE: There is still a great deal of argument regarding whether we are now in a primary bear market. Personally, I'm all for the debates and the arguments. After all, bear markets (and bull markets) thrive on disagreement and disbelief. If everyone thoroughly believed that we were in a primary bear market, they would all have sold their stocks on the same day and the bear market would have been over in 24 hours. Markets just don't work that way.

The truth is that I continually check, re-check and re-think the primary bear market thesis. Nothing is a "given" where the market is concerned -- nothing is carved in stone. The only sure item about the market is what has happened, never what's going to happen, and seldom even what's happening.

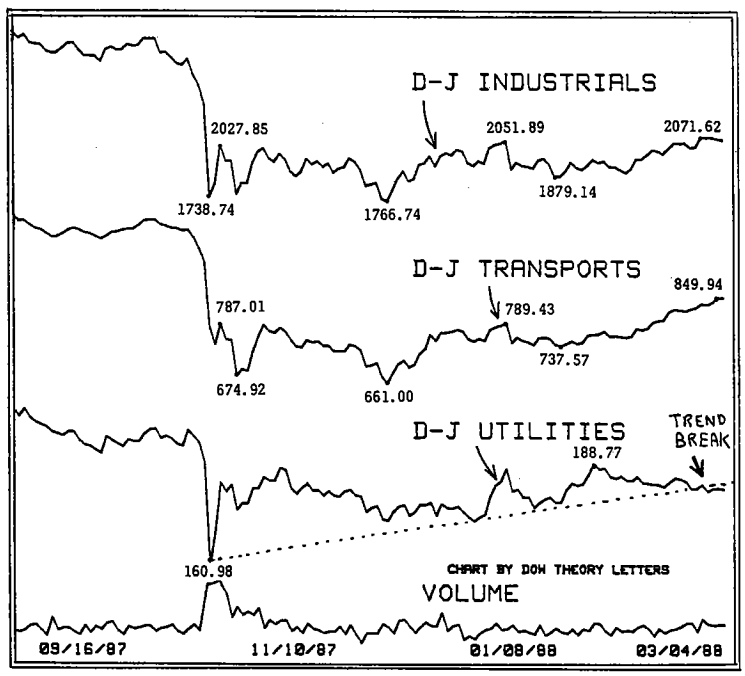
For instance, we can say definitely that the market crashed in October 1987. We can say that the Dow most definitely dropped 36% from its August high to its October 19 crash low, and that this kind of massive panic-decline is certainly characteristic of a bear market. Obviously those statements are safe. Why? Because they happened -- they are history. But what of the market today and tomorrow? Ah, now we're not dealing with facts, we're dealing in speculation, guesses, theories.

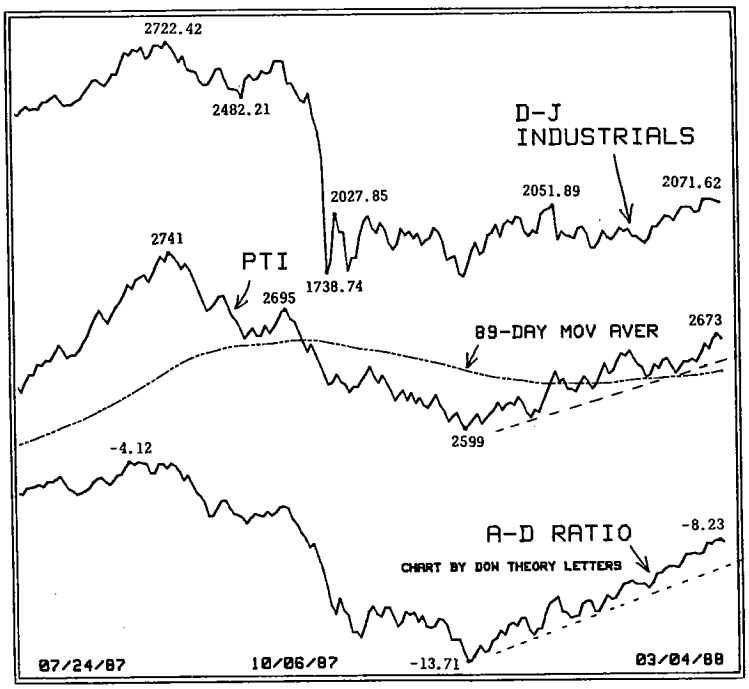
This is the way I analyze the picture. (1) Did we have a major bull market? Yes, we did. The bull market began in December 1974 and ended in August 1987.

(2) Was the 1974 to 1987 rise sufficient in duration and extent to qualify as a bull market? Yes, the rise lasted 13 years and advanced the Dow 2145 points or 371%. By any reckoning, that was a major bull market.

(3) Did the bull market produce a recognizable third (psychological) phase, and did it generate all the elements of a classic third-phase top? In my opinion, it did. During 1987 the Dow (and the other averages and indices) rose to extremes of overvaluation based on yield, book value, and price/earnings ratios. Exchange volume also was commensurate with a bull market top. Speculation was rampant, junk stocks and bonds were floated freely, rumors were rife, and sentiment was overwhelmingly bullish with "Dow 3600" a promise that was in every investor's and speculator's vocabulary. Margins and free credit balances were at extreme highs. In brief, every condition for a classic third-phase bull market top was in place.

(4) With all this in mind, did the Averages produce a classic bear market signal? The answer is yes, they did, and I discussed this repeatedly in Letters before and after October 15. Furthermore, I wrote an article for *Barron's* during the week ending October 12





(the article was published on October 19) pointing to the significance of a breaking of critical lows on the D-J Industrial and Transportation Averages. I stated that if those two lows were broken, such action would confirm the existence of a primary bear market. The lows were broken. The importance of the two lows was heightened by the facts that (a) literally no one was cognizant of those lows, and (b) very few investors or traders were thinking in terms of a major or primary bear market. The bear signal and subsequent action came as a complete surprise.

(5) Was the action following the Dow Theory bear signal decisive on the downside? The answer here is yes, the October 15 bear signal was followed by the greatest crash in Stock Exchange history. I don't know how market action following the bear signal could be any more authoritative.

Question: Couldn't the bear market have ended on that horrendous crash day of October 19? After all, by October 19 the Dow had lost 36% from its August high.

Answer: Anything is possible in the stock market. Anything is possible, but I think it is highly improbable that a two-month, 36% decline in the stock market could have corrected a bull market that advanced the Dow 2,145 points over a period of 13 years.

Question: Russell, what would have to happen to convince you that a new bull market has arrived?

Answer: Let me give you a parable. Charlie Jones is 65 years old. He's visiting his physician, having his annual check-up. Charlie says, "Doc, I don't like being 65. Actually, I hate being 65. I want to be 35 years old again. What do I have to do?"

The doctor answers, "Charlie, I don't know how to break this to you, but there's no way on this green earth that you're ever going to be 35 again. You can try monkey glands, youth pills, hair transplants, health spas, blood transfusions -- try 'em all, but the fact is that you're 65, going on 66. That's the bad news. The good news is that I happen to believe in reincarnation."

Well, that's about the way I see the stock market at this time. We've had the fun, we've had the good times, we've had the 13 years of inflation, deficits, and rising prices. But the bull died in 1987. Now the bear has taken over, and the bear has got to do its thing before anything else happens. After the bear market is over, after we've gone through the three phases of the bear market, then we can start looking for a new bull market. You can't have a day, and then another day without an intervening night. And you can't have two big bull markets with just an intervening two-month correction. At any rate, that's the way I see the situation.

Question: What are the indications that we're now in a bear market?

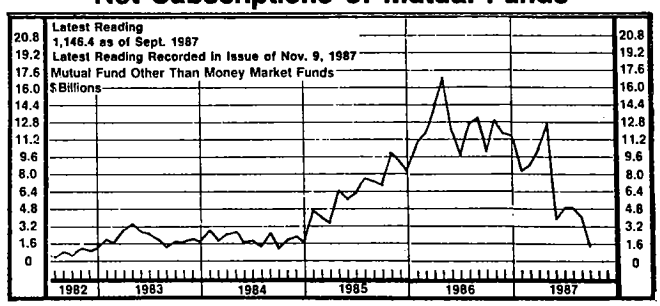
Answer: First, the October 15 bear signal. Second, the crash. Third, the prevailing disbelief. Fourth, the generally declining volume on the NYSE. Fifth, the sinking levels of Margins and Credit Balances on the NYSE. Sixth, the fact that the Dow is holding persistently below its 200-day moving average.

IT AIN'T EASY: You know, this is a tough piece to write, -- tough because I know that no one wants to hear it. But in this business you either deal with reality or you wear patched pants and shoes with your toes showing. And as I see it, as my studies suggest it, we're in a primary bear market. There's only one major question on my mind -- how will the bear market develop and how can I keep my subscribers from losing their shirts while the bear market is developing.

The answer, as I see it, is to provide my readers with as much information and knowledge as possible. So let's begin.

First, bear markets are shorter than bull markets, and they therefore have to do their work faster. So they are generally more volatile. And so far, this bear market has been no exception. The volatility serves to scare the public. The public was frightened first by the crash, and now it is being frightened by the volatility. This is seen in the astounding drop in mutual fund purchases. For instance (see chart), in January net sales of mutual funds were $1.8 billion compared with $18.1 billion a year earlier. December's sales were $1.1 billion and November's $500 million. In October nearly $5.8 billion exited from the funds.

Net Subscriptions of Mutual Funds



This has produced havoc on Wall Street and in the fund business. Recently Fidelity (the largest fund group) announced that they were laying off 800 people or 10% of their work force. During January shell-shocked investors poured $23.8 billion into money market funds, the biggest month for the money funds ever.

Much is being made of the superior performance of the A-D ratio and the broader indices as compared with the laggard performance of the D-J Industrial Average. This action, it is held, is indicative of a powerful market. Actually, as of last week, the S&P 500 had recouped 38.5% of its bear market losses, the broad NYSE Index had recouped 37.1% of its bear market losses, while the Dow had recovered only 31.8% of its bear market losses.

But Marty Zweig (who does a good deal of fine, original research) in his Feb. 25 report notes that in the first three months of 1930 (when the great post-crash rally was in force) his unweighted index shot up 24.9% while the Dow gained a mere 15.3%. That was" great positive divergence," notes Zweig. "But by year-end the Dow had plunged 44%. Then came the early 1931 rally. In the first two months of that year the (unweighted average) shot up 30.4% while the Dow gained just half of that, 15.2%. From there to year-end the Dow sank another 59% (it was the worst year ever). Once again prices rallied in January-February 1932. The (unweighted average) jumped 11.2%, the Dow rose just 4.5%. By July the Dow had collapsed another 50%." Marty then offers other examples of the

broader indices outperforming the Dow -- prior to disastrous declines. His point is that the broader averages often outperform the Dow following bear market collapses.

Zweig concludes the "positive divergence" (i.e., the A-D outperforming the Dow) "is normal after crashes which lead to continuing bear markets. It's part of the syndrome which traps investors." Certainly, the superior performance of the A-D ratio is on every analyst's lips today. (*Zweig Forecast*, P.O. Box 5345, New York NY 10150.)

Margins and Free Credit Balances on the NYSE lend credence to this being a primary bear market (see discussion in the last Letter). The latest statistics for January show that debt or Margins on the NYSE droped $670 million in January to a 20-month low. Thus, the speculators (who use margin) are being slowly beaten to death. At the same time Free Credit Balances dropped $445 million, the third consecutive monthly decline. During the course of the bear market both Margins and Free Credit Balances will tend to decline steadily -- until the bear market ends.

Next, the powers that be are growing bolder and more bullish. They're to the point of dropping their caution. Last week *Shearson Lehman* saw fit to bring out a full page ad in major newspapers across the nation proclaiming in a "Where We Stand on the Stock Market" ad that "The Worst is Over." Maybe so, but where was Shearson last October? I don't remember any full page ads proclaiming that history's greatest stock market crash is just around the corner. In fact, I don't remember any brokerage house ads (or any other ads for that matter) warning that the stock market was even on dangerous footing.

Bear markets generally generate deflationary pressures. The reason is because lower equity markets have a way of putting pressure on the price of everything from commodities to real estate. Lower prices also exert a depressing effect on consumers' psychology. At any rate, the CRB Commodities Futures Index is down 15% over the last month, oil has broken down below $16 a barrel, and precious metals prices have dropped sharply, all indicative of deflationary pressures.

As I've said many times before, deflation in a healthy economy can be handled and may even have a healthful, corrective benefit. But deflation in a debt-logged economy, such as the US economy today, is a different story. A powerful and persistent trend to deflation could send the US into a money-panic depression, a depression beyond the manipulative control of the Federal Reserve Board.

The fact is that the current position of the US is different (economically) than any it has ever experienced before. The difference is that we are now the world's largest debtor nation. This means that we are no longer master of our financial fate. The telltale indicator in this situation is the price of the dollar.

The US depends on foreign nations to buy its Treasury debt. But with continuing budget deficits, foreigners will only buy our debt if they have faith in the dollar. Thus, the stability of the dollar is crucial. This situation places the Fed in a bind. If the economy weakens, the Fed will have to be very wary about (1) increasing the money supply indiscriminately, or (2) raising interest rates. The first would frighten foreigners, and the second would squeeze the US economy.

I have stated that the government (particularly in a pre-election year) will do everything in its power to fight the bear. One example of this may have been seen last week when the January Leading Economic Indicators were released. The latest January figure was down 0.6, which represented the fourth month of decline. But no, the Commerce Dept. revised the December figure from down 0.3 to up 0.3, thus disrupting what would have been a bearish four consecutive declining months in the lead indicators. Can Washington keep this up until election time? They'll certainly try.

Only 25% of the National Association of Business Economists (200 economists in all) believe there will be a recession this year, but an overwhelming 83% of the 200 think that a recession will occur in 1989. However, I've noticed that when the experts are placing the next trouble "a year away" or in this case "after the election," the markets and the economy have a nasty habit of not obliging them. In view of this, it will be most interesting to see whether the economy can stay "on even keel" until election time.

INVESTMENT POSITION: In the investment business there are two kinds of money — your own money, and the customer's money. A lot of my subscribers are professionals, and they handle other people's money. These pros don't use my strategy and I'm sure they don't follow my advice -- at least they don't when they're dealing with fund or pension money. Why? Because they're in the performance business, and if you have to perform you also have to hold stocks and you have to take chances, chances you wouldn't necessarily take with your own money. So the pros tend to read these reports for information or to check their own opinions (which are often very good) against mine.

But the majority of my subscribers are individual investors, people who want to, and can afford to, play it safe in a bear market. One of my cardinal investment rules is that "If you don't lose money, you'll tend to make money." That's a very simple rule, but it works The "don't lose it"' rule is particularly applicable during a primary bear market. The man or woman who is smart enough and patient enough to avoid bear market losses will usually come out a winner in the game of investments.

OK, we've heard the "don't lose it" rule, but how do you avoid losing it in a primary bear market? Answer: you stay out of the market. Sounds easy, but believe me it's easier said than done.

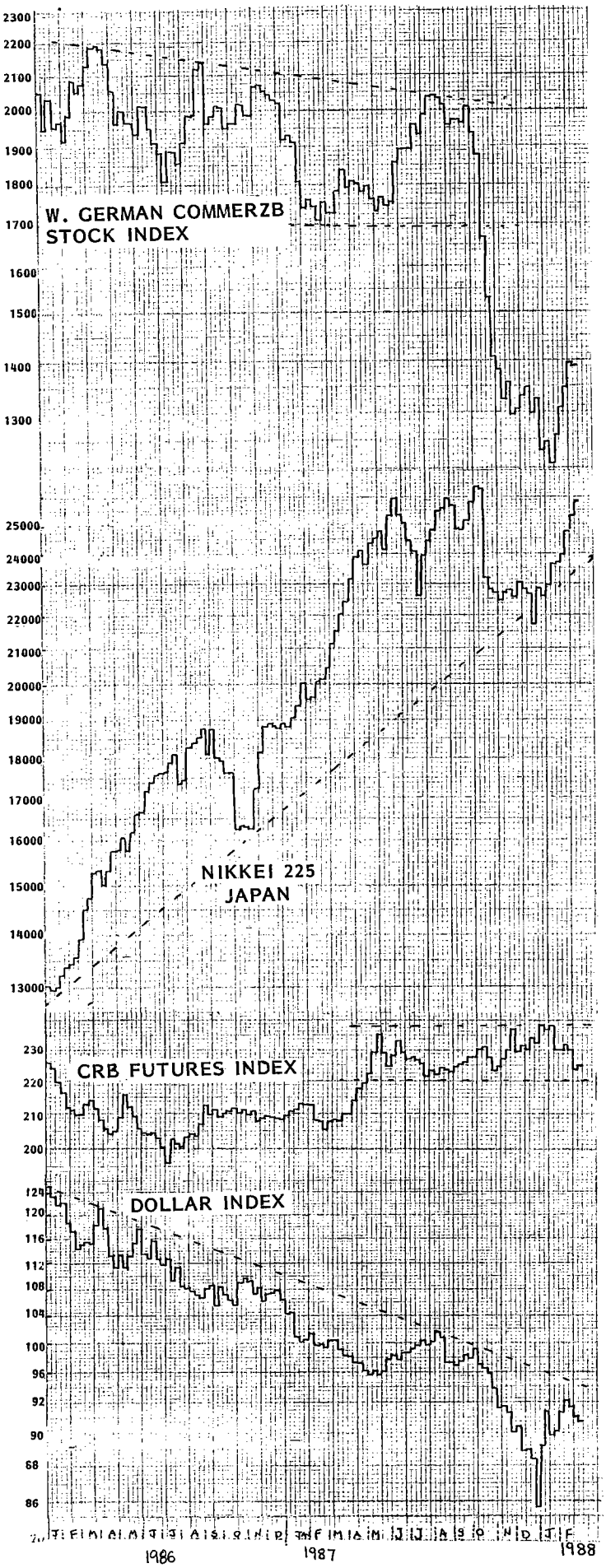
The bear rules the box. And we'll continue to avoid potential losses by standing aside.

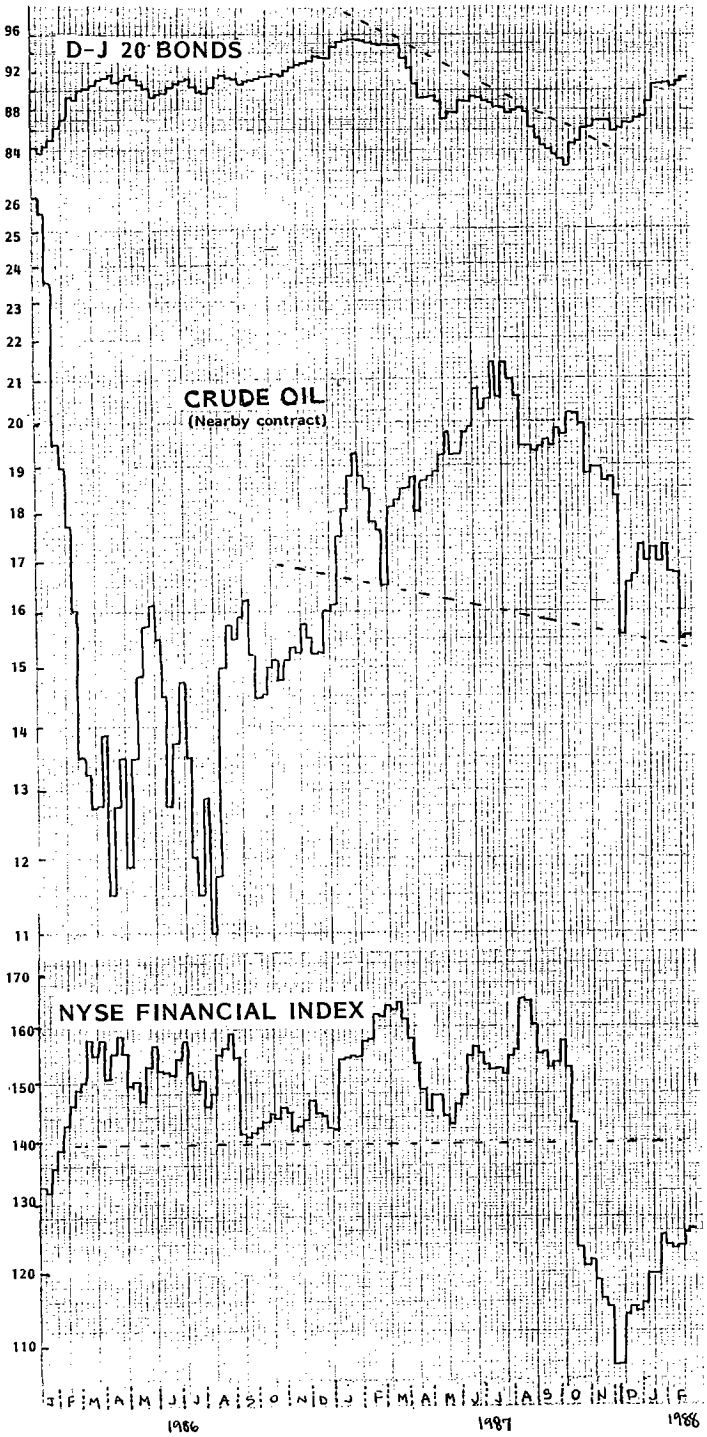
CHARTS: Often, after sifting through my daily reading of eight newspapers and maybe five or six magazines and usually a few dozen reports, I'll sit back, cast my eyes heavenward and say, "Prices, prices, spare me all the mumbo-jumbo and long-winded analyses, just give me the prices, the prices."

And basically, prices are what most charts are all about. The charts I get most out of are price charts -- statistics plotted on a graph so that the eye can readily see trends and patterns. Charts are stories of what people are willing to pay for given items over a given period of time. I like ratio graphs which portray moves in percentages. On an arithmetic chart a rise from 40 to 50 will take up the same vertical distance as a rise from 1010 to 1020, which is absurd. A ratio chart will show the move correctly -- in terms of percentages. The following are all ratio charts (weekly Friday closings).

The West German economy is known as "the economic engine of Europe." In view of that, I believe the collapse of the German stock market is very significant. The German market is now down 45% from its 1986 high. That is a major drop, and I call it a bear market. The real GNP of Germany has slowed to under 2%, and my guess is that this year the German GNP will at best be flat. The strong German mark has hit their export trade hard, and Germany is experiencing a deflationary, recessionary trend (but since the Germans are mortally afraid of inflation, this doesn't bother them).

All eyes are on the Japanese stock market. Why? Because Japan is now the world's hottest producer. Japan also boasts the world's most expensive (major) stock market with average P/E's around 65. In the October crash, the Japanese market fared much better than the US market, and Japan's market is now within easy shooting distance of its 1987 high. Analysts are watching the Nikkei with bated breath. Will it go through the highs? Will it top out and crash? This is turning out to be the No. 1 question of 1988.





Inflation or deflation -- or stability? The Fed is walking the tightrope, trying its best to keep the US economy on an even keel -- at least until after the election. The widely-watched CRB Commodities Futures Index held around the 230 level for many weeks, but more recently it has dipped to the 225 area. Conclusion: Minimum inflationary pressures at this time.

Some analysts are convinced that the dollar has bottomed while others are equally convinced that this is just a breather -- preparatory to new lows. The spike bottom in the Dollar Index indicated a very oversold dollar, but my chart does not yet show that the dollar has seen a major reversal to the upside.

The D-J 20 Bond Average recorded its low in October and has been climbing ever since. The bonds formed a powerful head-and-shoulders bottom and have recently pushed up over the 90 level -- quite an accomplishment. But to go to new highs, the 20 Bonds will have to rally over 96. And that's a long haul from here.

This could be the most important chart of all. As you can see, crude oil since 1986 has been one of the wildest items in the entire market spectrum (wildest in terms of percentage moves). The price of crude is critically important because oil represents the collateral behind billions of dollars in bank loans and because the world's industry is so closely tied to oil.

Note the huge head-and-shoulders top pattern in crude oil. Crude is well down from its 1987 high and is flirting with support at the 14.5 to 15.5 level. I would say that if crude cracks 14.5 we'll see fireworks. Oil below 14 would be a signal for deflation, a squeeze on the banks, a semi-depression in the US Southwest -- and, of course, favorably lower fuel prices for the utility and the transportation companies.

Not too many people follow it, but I do. I'm talking about the NYSE Financial Index. This important Index includes all financial stocks from the S&Ls to the brokerage houses to the banks and small loan companies. The Financial Index dropped around 35% from its 1987 high to its crash low. Since then it has recovered about 30% of its bear market losses. The importance of this Index can not be overemphasized. Note that all during 1986 and most of 1987 the Financial Index moved generally sideways, thereby missing out on the big move in the other averages. Lately, however, with much of the rotten bank news out in the open, the Financial Index has been doing better.

NOTES & QUOTES: Now that he is no longer Fed Chairman, the highly-respected Volcker is saying what he really thinks. I include a little piece buried in the pages of the Feb. 22 *New York Times* (had he said this while Fed Chairman it would have made headlines):

WASHINGTON, Feb. 21 (Reuters) — Paul A. Volcker, the former Federal Reserve Board chairman, warned today of financial chaos and recession unless the United States reduced its dependence on foreign savings by reducing the Federal budget deficit.

Mr. Volcker, who stepped down from the central bank in August, said the United States could not indefinitely sustain its current rate of borrowing because foreign investors would lose confidence.

"Borrowing at the rate of $150 billion a year or so carries the seeds of its own destruction," he said at a meeting of the National Governors Association. "We are on a course that is essentially unsustainable."

Mr. Volcker said that if the nation did not reduce its thirst for foreign savings in an orderly way, preferably by cutting the Government deficit rather than by slashing investment, the financial markets would force an adjustment. He said that the October stock market collapse, the surge in interest rates and the slide in the dollar showed the substantial risks of leaving the job to the markets.

His comments contrasted with the optimism of President Reagan's Council of Economic Advisers, which said on Friday that America's foreign debt was modest in relation to the nation's income and wealth.

Mr. Volcker, who resigned after the President declined to offer him a third four-year term, disagreed.

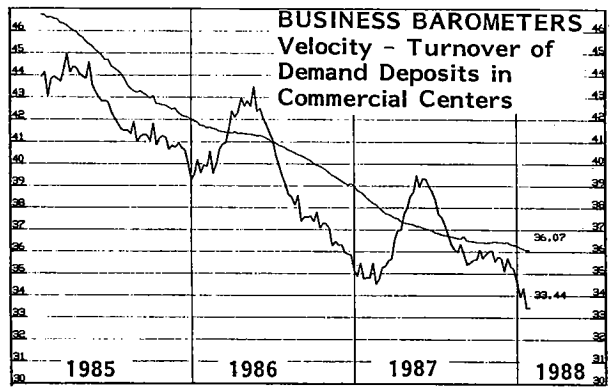
* *

Speaking of deficits, Democratic candidate Michael Dukakis boasts that he's balanced his state budget nine times. While Dukakis huffs and puffs, he leaves out the fact that the federal government pays out up to $100 billion in grants every year. The fact is that 18% of all revenue received by state and local governments come from the federal government. Without the federal grants, no state or county manager could mouth off about "a balanced budget." So hypocrisy rules at the state and local level, just as it does at the federal level.

* *

One indicator I nave been watching with increased interest is "velocity" or the turnover of demand deposits at the main commercial bank centers. This chart (courtesy of Mansfield) tells a rather fascinating story. Although the various money supply statistics show that the money supply of the nation is increasing (although at a very decreased rate in 1988) the turnover of this money has been decreasing -- and decreasing at an alarming rate since mid-1987.

Ordinarily, this would signify a slowing of business or a slowdown in the use of money. When the Fed sees velocity caving in, it usually moves to pump up the money supply and thus offset the decline in velocity. Therefore, it is most unusual to see the rate of change in the money supply decline along with a steady decline in money turnover. Maybe it was this bearish twin phenomenon that the market saw last October when it crashed. Time will tell.



* *

The government is adding $240 million to the IRS's current budget of $5.8 billion. This $5.8 billion amounts to an expense of $15 million a day, 365 days a year -- all to collect taxes. I still say that a flat, across-the-board tax would be unbelievably easier, would save the government a fortune, and would save taxpayers millions of headaches. Of course, it would put the "tax fraternity" (tax lawyers, tax firms, tax publishing companies, tax accountants) out of business.

* *

US News & World Report (Feb. 29) asked 10 political analysts about the presidential candidates. There's much right with the guys, but here's what the analysts thought was wrong with each of them: Dole " . . . is abrasive, has a mean streak and an inability to delegate. Weak organization, especially in the South." Bush " . . . is perceived as an overgrown preppie, not a strong leader. Doesn't project his message as well as he should."

Kemp "[t]alks too much, has no presidential demeanor. Overemphasizes narrow issues. A Johnny-one-note on the economy. Perceived as too extreme." Robertson " . . . half the country thinks he's a religious weirdo. Never held elective office. He scares people." Gephardt " . . . is immature, too much of an opportunist." Dukakis " . . . perceived as a technocrat with lack of vision, passion. Has no foreign policy experience, is too liberal for the South." Gore " . . . seems pushy, opportunistic, a yuppie on the make. Liberal record gets in the way of conservative, tough-guy rhetoric; at 39, perceived as too young." Simon " . . . looks like understudy to Pee Wee Herman. Lacks Presidential demeanor. A big spender, out of tune with the party." Jackson " . . . polarizes with message far out of the mainstream."

* *

Progress: According to a CBS report, the following were the seven major problems reported by schools in 1940: Talking out of turn, chewing gum, making noise, running in the halls, dress code infractions, and loitering. In 1987 the seven major problems are drug abuse, alcohol abuse, pregnancy, suicide, rape, robbery, and assault.

* *

Trumped: Donald Trump has always wanted an NFL football team, so it was not surprising when he went after the up-for-sale New England Patriots. But Trump lost interest when his accountants told him that "this is one of the worst financial messes" they had ever seen. The Patriots are owned by Boston's Sullivan family, who are deep in debt. Trump's people told him (according to the *Boston Globe)* that "between the team and the stadium there was a $104 million debt, and that was too much for him (Trump) to handle."

* *

Olympics: They tried hard, but there were few victories. Out of 123 events at the Winter Olympics, Americans won only 6 medals, their worst Olympic showing in 52 years.

* *

Nordstrom Dept. Stores (mostly apparel) is finally invading the East. It opened its first East Coast store last week in McLean, Va., just outside the hot Washington, D.C., retail market. Those of us on the West Coast (57 stores here) who are used to Nordstrom's great in-depth selections and fabulous service know what's going to happen to the competition when "Nordy" comes to town. In a phrase, "Nordy's will kill 'em."

* *

Savings rates are down in almost all major industrialized nations. But in Japan the savings rate is an incredible 24% and in Korea, where the government taxes consumer products heavily (in order to discourage consumption and encourage exports), the savings rate is over 30%.

* *

States: With oil prices caving in, Texas now has more people leaving the state than coming in. (Estimate: An exodus of about 50,000 this year.) Taxes on cigarettes will bring in more for Texas than oil this year. Exception: Austin, fast becoming a national electronics and computer center.

Meanwhile, Georgia is where it's happening. The Atlanta airport now the busiest in the nation. And Georgia's Gwinnett County is now the fastest growing county in the US with number of households up 62% from 1980 to 1985.

* *

The Japanese now control five of California's 10 largest banks. California First (controled by the Bank of Tokyo) just paid $750 million for Union Bank, which is the fifth largest California Bank. Ironically, that's more than a US bank could do. Citicorp wanted to buy Union Bank, but California law prohibits it.

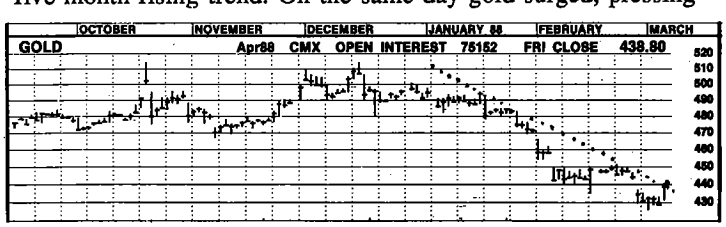
* *

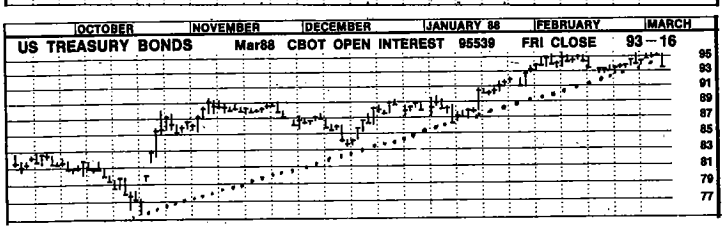
When Wall Street is in trouble, goes the old adage, the rest of the nation is not far behind. Wall Street is in trouble. One problem is that the firms are stealing key brokers from each other. A second trouble is investment losses -- many firms took big hits in the bond market last spring and further hits in the stock market last fall. Finally, business (volume) has dropped off as the pubic has pulled out of the various markets. The result: The brokerage industry had a pre-tax profit of $5.5 billion in 1986. In 1987 it is estimated that profits dropped 35 to 40%. This year the estimate is another 20% slide in profits.

* *

Election facts: The once indomitable Southern Democrats are facing hard times. Their party has won only one of the past five presidential elections, and then only when it nominated a conservative Southerner, Jimmy Carter. If the Dems are to capture the White House in '88, they must win the South (which is turning Republican and conservative). Fact: No Dem has ever been elected president without carrying Texas, and this is now hard to do unless Dems nominate a conservative and preferably a Southern conservative. Big change in the South: Racial bias is out. Why? It's bad for business, and the South wants business in move in.

BONDS, GOLD: Bonds up, gold down = disinflation or deflation. Bonds have been rising since the October crash and gold has been declining since the first of the year. The story is in these two charts (charts courtesy of *Investor's Daily*). My feeling is that both trends are very extended, which is another way of saying that bonds are very overbought and gold is very oversold. The March T-bond contract appears to have formed a "double top" in the 95 area. On March 4 the bonds used the Government's "higher employment figures" as an excuse to gap down. In so doing, they broke their five-month rising trend. On the same day gold surged, pressing hard against its three-month declining trend. The 144-day exponential moving average of gold (which I follow closely) now stands at 461.

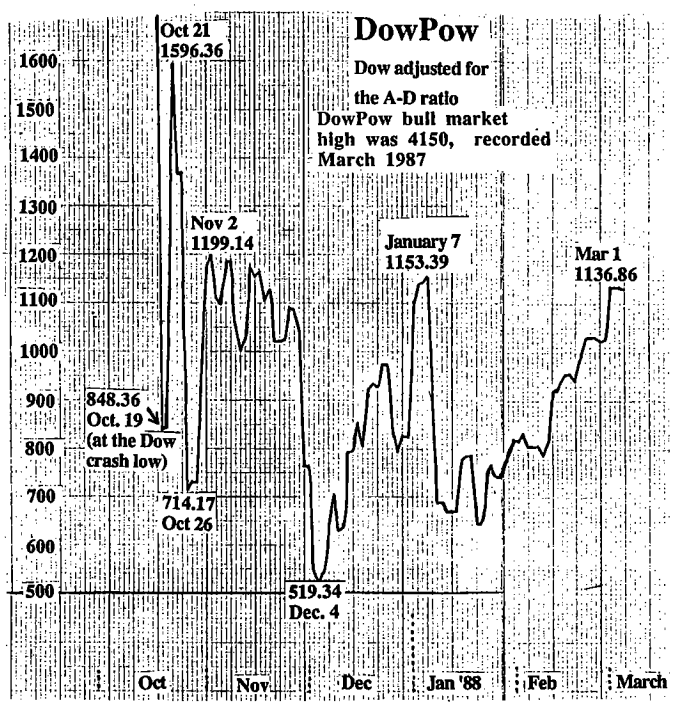




I'm just plain stubborn. I continue to buy municipal bonds because I feel they are good value compared with anything else I see around -- and as veteran subscribers know I tend to be "a compounding nut." I also continue my once-a-month purchase (fixed dollar amount) of gold coins. I do it because gold is the only money in the world that isn't someone else's liability. Also, in these days of rising mountains of debt, I find it comforting to know that I can own something that the other guy can't degrade, bankrupt, inflate away, or otherwise destroy.

With it all, I can't seem to get over to some people the concept that gold bullion and gold mining shares are two different animals. A gold mine can go bankrupt, it can deplete itself of ore, it can burn, it can go on strike, it can be taken over by a hostile government. But gold in coin form is yours to hide, to hoard, to put in your vault, or to give to your grandchildren. Would you give shares in a gold mine to your grandchildren? I wouldn't suggest it -- the odds on the mine being around 25 years from now are not good. At any rate, gold and muni bonds tend to go in opposite directions. But I'll take a portion of each -- for totally different reasons.

LATE NOTES: I'm placing DowPow in late notes because the action of DowPow is so strange (DowPow, by the way, is my proprietary index of the Dow adjusted for the action of the A-D ratio). As you can see on the chart, DowPow hit a recent high of 1136.53 on March 3. This is just below the peaks recorded on November 2 and January 7 (and far below the October 21 peak). Will DowPow finally reverse its five-month pattern of declining tops? By the next Letter we should know.



The Dow, as stated earlier, confirmed the Transports when it bettered the 2051.89 peak. But the Dow has done little since that upside confirmation. This is both puzzling and disconcerting. The Dow might be focusing on (and upset by) the strange lag in the Utility Average. Or the Dow might be focusing on the fact that the A-D ratio has now risen in 12 of the last 13 weeks. That kind of breadth series, while impressive, is also indicative of a very overbought market.

A breadth correction should be coming soon. When it comes, it will be extremely important to see what the Dow does. Meanwhile, the Transportation Average, bulled by lower fuel costs and rising airline fares, has been the powerhouse of the three Dow Averages -- while the Utilities remain the mystery.

NEXT MAILING: March 23